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No. 80-2092

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

SCM CORPORATION,

Petitioner,

v.

XEROX CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

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Xerox's attempts to reargue a version of the facts rejected by the jury are unavailing, for this case turns entirely on questions of law. Both parties agree that, under the court of appeals' opinion, (1) all purchases of patents are exempt from the antitrust laws if made prior to the emergence of a relevant market and (2) all purchases of patents are exempt from the *duPont* rule, *i.e.*, the rule that the legality of an acquisition under the antitrust laws may be tested at the time its anticompetitive effects are demonstrable. (Br. Opp. 11-12, 18-19, 23).[1] The only questions presented in this Court are whether those exemptions—which immunize the wilful acquisition and maintenance of persistent, substantial monopoly power—are legally sound.

[1] The Brief in Opposition is referred to herein as "Br. Opp."; the Petition for a Writ of Certiorari is referred to as "Petition." Other citations are as set forth in Petition 1 n.1. Subsequent to the filing of the Petition, the decision below was reported officially; the citation is 645 F.2d 1195 (2d Cir. 1981).

Five days after the Petition for a Writ of Certiorari in this case was filed, this Court unanimously reaffirmed that implied exemptions "can be justified only by a convincing showing of clear repugnancy" between the antitrust laws and the other law, and that exemptions "are especially disfavored where the antitrust implications of a business decision have not been considered by a governmental entity." *National Gerimedical Hospital & Gerontology Center* v. *Blue Cross of Kansas City,* No. 80-802, at 10, 12 (June 15, 1981). The Brief in Opposition does not even try to justify the decision below on the basis of the standards reconfirmed in *National Gerimedical.* Indeed, the Respondent is able to urge only one reason for denying certiorari in this case: Xerox contends that the questions presented do not "offer this Court the opportunity to settle any significant recurring issue under the Sherman Act or the Clayton Act." (Br. Opp. 15). That proposition is manifestly untrue.

I. THIS CASE PRESENTS IMPORTANT QUESTIONS OF BROAD APPLICABILITY

To argue that the facts of this case are "unique" (Br. Opp. 24) is to prove nothing. The facts in every case are unique. The question is not whether these identical facts will recur, but whether the legal principles announced in the decision below will have broad applicability. The answer to that question is "Yes."

With respect to Question 1 presented by the Petition, Xerox urges that the court of appeals' decision was limited to the facts of this case. (Br. Opp. 14). But, in describing the decision below, Xerox recognizes that the *only* dispositive fact in that decision is that a relevant market had not emerged at the time the 1956 Agreement was made. (Br. Opp. 11-12). Under the decision below, therefore, *all* purchases of patents prior to the emergence of a relevant market are exempt from the antitrust laws. That holding is in no way "limited" to the facts of this case.[2]

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[2] *Cf. National Gerimedical Hospital & Gerontology Center* v. *Blue Cross of Kansas City,* No. 80-802 (1981) (certiorari granted to review an implied

It is tautological that, for *every* discovery that creates a new market, the relevant market created by the invention does not exist when the discovery is made. With every discovery that creates a new market, there is a period of engineering or mechanical development, design, product introduction and initial sales occurring well before the new relevant market comes into being.[3] The decision below eliminates antitrust scrutiny for every patent purchase during that entire period. To say that an antitrust exemption for patent purchases where the market has not yet emerged is a non-recurring issue is to deny that important new discoveries will be made.[4]

Xerox does not even suggest that Question 2 presented by the Petition is a question that will not recur, and any such suggestion would be untenable. Nor does Xerox suggest that the court of appeals' unsupported holding that the *duPont* rule does not apply to patent purchases is in any way dependent on the facts of this case. The validity of the court of appeals' holding in this regard is indisputably an issue of broad applicability.

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antitrust exemption, despite unique facts that are unlikely to recur, because of the importance of the broad legal principle involved).

[3] Accordingly, that convenience office copiers and plain paper copiers did not become relevant markets until after January 1964 is not unusual. Moreover, sales of convenience office copiers, which were substantial in 1956, surpassed $175,000,000 in 1958 and exceeded $1 billion from 1960 to 1963. In the 1960-1963 period, sales of plain paper copiers alone were $225,000,000. (Petition 4 n.4; E 2664, 2816-17).

[4] In urging that the facts of this case are unlikely to recur, Xerox also relies on the fact that it purchased the patents from Battelle, a nonprofit institution. This fact does not render Question 1 non-recurring because the court of appeals' exemption is not dependent on the status of the patent seller. (*See also* note 8, *infra*). Moreover, the great majority of the basic research in this country is performed by universities and other nonprofit institutions like Battelle, which conducted an estimated 69.2 percent of the basic research in 1980. *See* NATIONAL SCIENCE FOUNDATION, NATIONAL PATTERNS OF SCIENCE AND TECHNOLOGY RESOURCES 14 (1980). At some stage, the product of that research is transferred to commercial entities, and an increasing number of nonprofit institutions are entering into exclusive arrangements with commercial firms. *See* Biddle, *A Patent on Knowledge,* HARPER'S 22-26 (July 1981); DEPARTMENT OF JUSTICE, ANTITRUST GUIDE CONCERNING RESEARCH JOINT VENTURES App. B, at 6-7 (1980) (discussed in Petition 18 n.19).

The issues involved here are not only likely to recur; they will recur in a context of great national importance. Perhaps the single most important area of our economy today is the development of new technologies, products and services. Competition in these areas is crucial to innovation and economic growth. Yet the decision below allows competition to be precluded in the development and exploitation of new technologies, and in the production and distribution of new products and services. Those determinations present recurring issues of special importance.[5]

The issues raised by the court of appeals' decision go to the heart of the relationship between the antitrust laws and the patent laws, raising significant questions as to the continued vitality of this Court's opinions accommodating the antitrust and patent laws from *Standard Sanitary Mfg. Co.* v. *United States,* 226 U.S. 20, 49 (1912), onward. Those issues should be reviewed by this Court.[6]

II. THE EXEMPTIONS CREATED BY THE COURT OF APPEALS CANNOT BE JUSTIFIED

Xerox's brief fails to justify the exemptions created by the decision below in terms of the applicable criteria referred to in the Petition and this Court's recent decision in *National Gerimedical Hospital & Gerontology Center* v. *Blue Cross of Kansas City,* No. 80-802, at 9-10 (1981). Xerox just asserts that an exemption for patent purchases made prior to the emergence of a relevant market is the "only possible accommodation" between the antitrust laws and the patent laws. (Br. Opp.

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[5] Most dominant firms today license their patents. (*See* PA 67a). Under the court of appeals' decision, however, fewer firms will license, and more will seek to acquire exclusive patent rights. The result will be less competition, without any incremental benefit to the policies of the patent laws. (*See* Petition 23-24 & n.26).

[6] In contrast to the decision below that the Rule of Reason does not apply, compare, *e.g., Transparent-Wrap Machine Corp.* v. *Stokes & Smith Co.,* 329 U.S. 637 (1947); *Standard Oil Co. (Indiana)* v. *United States,* 283 U.S. 163 (1931); *see also* Petition 14, 17, 20 & n.22.

16-19). Such *ipse dixit* is no more a "convincing showing of clear repugnancy" than was made in *National Gerimedical.* Xerox has no answer to SCM's demonstration that the proper accommodation of the antitrust laws and the patent laws is achieved by applying the Rule of Reason. (Petition 15-18). The Rule of Reason gives effect to the policies underlying *both* laws. An exemption is no "accommodation" at all.[7]

Xerox also mischaracterizes the meaning of the Rule of Reason in trying to justify the court of appeals' exemptions. Xerox incorrectly argues that the Rule of Reason would invalidate acquisitions of patents even where "the acquisition does nothing more than transfer a legal monopoly from one person to another without augmenting its economic force." (Br. Opp. 18). To the contrary, such an acquisition would be upheld under the Rule of Reason because it would have no adverse effect on competitive conditions. *See National Society of Professional Engineers* v. *United States,* 435 U.S. 679, 688-92 (1978). In contrast, the 1956 Agreement at issue here had a substantial effect on competition. By purchasing all of Battelle's patents and know-how and eliminating Battelle's power to compel sublicensing—a power the jury found Battelle would have exercised by granting licenses to SCM and others by

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[7] Xerox contends that it is a "fundamental misconception" to say that patents confer no immunity from the antitrust laws. (Br. Opp. 16). But Xerox cites no case holding that patent holders are immune, and this Court's decisions establish the contrary. *E.g., International Salt Co.* v. *United States,* 332 U.S. 392 (1947). None of the cases on which Xerox relies provides any support for an exemption for patent purchases prior to the emergence of a relevant market. Whatever relevance the dicta in *Walker Process Equipment, Inc.* v. *Food Machinery & Chemical Corp.,* 382 U.S. 172 (1965), and *Precision Instrument Mfg. Co.* v. *Automotive Maintenance Machinery Co.,* 324 U.S. 806 (1945), may have with regard to a monopoly achieved by an inventor, those cases are not applicable to the exemptions created by the court of appeals here. Nor does *United States* v. *Aluminum Co. of America,* 148 F. 2d 416 (2d Cir. 1945), support Xerox's position. The *Alcoa* court was never asked to pass on the legality of the first Alcoa patent acquisition; and as to the second, the court's disposition made it unnecessary to overturn the trial court's factual determination that it was reasonable because it avoided a patent deadlock. *See United States* v. *Aluminum Co. of America,* Eq. No. 85-73, Findings of Fact Nos. 32-36 (S.D.N.Y., filed July 14, 1942).

1969—Xerox changed a competitive future market into a monopolized one.[8]

Xerox also urges that application of the Rule of Reason would discourage commercial success by invalidating any exclusive license that eventually confers substantial market power. (Br. Opp. 18-20). Again, Xerox misrepresents the Rule of Reason. The Rule of Reason does not penalize commercial success; it encourages success by allowing the patent purchaser whatever exclusivity is reasonably necessary to induce commercial development. Nor does the Rule of Reason limit commercial success to the inventor. Commercial success by investors generally is achieved without attaining monopoly power. Even where monopoly power is eventually achieved by an investor, that power may not have been reasonably foreseeable at the time of the acquisition and may be found to have resulted, not from the acquisition, but from the investor's superior skill. *Cf. United States* v. *Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). And even where monopoly power is foreseeable when the patent purchase is made, there may be no violation because the effort required to achieve commercial success might be such that exclusivity would be a reasonably necessary inducement.[9]

Beyond citing III P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 819 (1978)—the sole citation in the court of appeals' opinion on this point as well (PA 28a)—Xerox offers no economic, legal or factual authority for exempting patent purchases made prior to the emergence of a relevant market.[10]

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[8] Throughout its brief, Xerox refers to Battelle as a "non-competitor" in an apparent effort to imply that the 1956 Agreement had no effect on competition. (*E.g.*, Br. Opp. 18 & n.32). Xerox ignores the fact Battelle was a source of potential competition—competition which the 1956 Agreement eliminated. (*See* Petition 19 n.20).

[9] For example, the cost of testing and marketing a pharmaceutical might be so substantial in comparison to the available market that an exclusive license would be reasonably necessary. The exclusive license would have a substantial procompetitive effect—enabling the drug to be marketed—that would outweigh any adverse effect on competition. (*See* Petition 18 n.19).

[10] Areeda & Turner cite no authority for their assertion. Yet Professor Turner had previously concluded that exclusive patent licenses—even prior to commercialization—should only be allowed "for a reasonable period of time

Nor does Xerox's analysis explain how it can be proper to ignore the impact of such an exemption on potential competition. (*See* Petition 19-22).[11]

Finally, Xerox offers no justification for the court of appeals' exemption of patent purchases from the *duPont* rule. Xerox has no answer to the argument (Petition 25) that an exemption from *duPont* can allow patent purchasers to maintain monopoly power, as here, indefinitely. In contrast to the monopoly that may be dissipated by competition from new entries, the monopoly based on patents can be impregnable. The decision below allows invulnerable monopolies, not based on any superior efficiency, to be maintained into the distant future.

III. XEROX'S EFFORTS TO REARGUE THE FACTS SHOULD BE DISREGARDED

In an effort to divert the Court's attention from the real issues, Xerox presents a distorted version of the facts, a version the jury rejected. Neither the district court nor the court of appeals overturned *any* of the jury's factual findings, and Xerox's efforts to reargue the facts should therefore be disregarded. A few examples follow.

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on a showing that exclusivity was an essential prerequisite to any exploitation at all." Turner, *The Patent System and Competitive Policy*, 44 N.Y.U. L. Rev. 450, 462 (1969). Indeed, Professor Turner stated that it was "*clear* that the ordinary application of section 7 principles would have a relatively minimal impact on realizable rewards to patent holders." *Id.* at 461 (emphasis added). *See also* C. Kaysen & D. Turner, Antitrust Policy 178-79 (1959).

[11] Xerox argues that the "acquisition of any asset—a patent or anything else" prior to the emergence of a relevant market is per se lawful under the antitrust laws. (Br. Opp. 19). Xerox cites nothing in support of this proposition, and the precedent is to the contrary. In *United States* v. *E.I. duPont de Nemours & Co.*, 353 U.S. 586 (1957), the product which duPont sold General Motors in the auto finish market, Duco, was not invented until years after the stock acquisition involved. And there was no evidence of any separate relevant market for automobile finishes when the acquisition was made. *Id.* at 593-96, 631-34; *see also* 126 F. Supp. 235, 288-93 (N.D. Ill. 1954).

1. In this Court, Xerox contends—for the first time in this litigation—that SCM was excluded, not only by the patents Xerox purchased from Battelle, but by Xerox's internally-generated patents. (Br. Opp. i, 1, 7-8, 23). The record is to the contrary. At Xerox's urging, the jury specifically found that, prior to March 1969, it was impossible to make a plain paper copier without at least one of the patents—the "corona charging" patent—which Xerox had purchased from Battelle. (PA 117a). Other purchased patents effectively insulated Xerox from all competition even after the corona charging patent expired. (*See* Petition 13 n.13). Xerox did procure patents on its own, but the important patents were those of Carlson, Battelle and Horizons. In 1966, for example, there were seven patents that dominated Xerox's copiers; *none* resulted from research done by Xerox. (A 827-31; *see also* A 815-26).[12]

Xerox contributed no breakthroughs to the development of xerography. Indeed, Xerox conceded that it conducted no significant basic and fundamental research until after the introduction of the first plain paper copier in 1960. (A 893). As its own witness acknowledged, Xerox's contribution was simply a matter of engineering—which "hundreds of companies" had the talent to do. (A 2969). The jury was entirely justified in rejecting Xerox's contention that its monopoly was the result of any Xerox superior skill. (Petition 21 n.23). Xerox's effort to reargue that point here is unavailing.

2. Xerox's reference to IBM's decision not to join with Xerox in marketing the 914 and 813 (Br. Opp. 6-7, 21) is a transparent effort to reargue the jury's finding that it was reasonably foreseeable that the 1956 Agreement would give

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[12] Xerox never attempted to prove at trial that SCM could not have competed effectively without licenses on Xerox's internal inventions. Moreover, even if Xerox had done so, it would make no difference. Under Xerox's 1948 and 1951 agreements with Battelle, Xerox was required to assign to Battelle any xerographic patents it might obtain. Had there been no 1956 Agreement, Battelle would have retained the power to compel sublicensing of those patents, in addition to its own. (Petition 3; E 496-98, 504).

Xerox a monopoly—a finding which the court of appeals specifically upheld (PA 30a).[13]

3. Xerox's argument that Battelle would not have compelled sublicensing to SCM (and others) by 1969 in the absence of the 1956 Agreement (Br. Opp. 21-22) is an especially egregious effort to reargue the facts on which Xerox lost below. The jury specifically found otherwise (PA 123a); the jury's determination was based on clearly sufficient evidence (*see* SCM's Reply Brief below, at 45-53); and the court of appeals declined Xerox's invitation to overturn that finding. For purposes of review in this Court, the jury's demonstrably correct finding must be taken as established.[14]

4. Xerox disputes SCM's statement (Petition 13 & n.13) that, were it not for the FTC decree, Xerox would still have a complete monopoly today, forty-one years after the first xerographic patent issued. Xerox's argument is that, prior to the FTC decree, a number of plain paper copiers were marketed by other companies. (Br. Opp. 7 n.11). What Xerox does not

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[13] Xerox's argument is not only contrary to the decision below; it ignores the pertinent facts. Xerox's own documents confirm that, prior to IBM's decision, Xerox's top managers had unanimously recommended that Xerox decline IBM's offer to work together in manufacturing and marketing the 914 and 813 because of the enormous profits they realized would be derived from exploiting xerography *alone*. Xerox's managers predicted making "record-breaking history," concluding that it would be "easy for [Xerox] to move beyond the one hundred million dollar sales bracket and up into the five hundred million dollar bracket" (E 2062, 2104; *see also* A 903; E 680, 1679-82, 2081, 2090, 2092). After learning of IBM's decision, Xerox was in no way discouraged. Its president correctly and "confident[ly]" stated that Xerox's new copiers would "substantially change the volume and income of the company . . . within three years" (E 2757-59; SA 506-07).

[14] Also unavailing is Xerox's reargument of its so-called cash-flow motivation for the 1956 Agreement. (Br. Opp. 6, 20). Any favorable cash-flow effect from the agreement could as easily have been accomplished—without adversely affecting competition—by paying royalties in stock rather than cash or by a sale with Battelle retaining control over sublicensing. Moreover, research and development expenditures notwithstanding, Xerox "was not draining itself of resources. Far from it. The company was paying its shareholders regular dividends." (E 1076). During the 1955-1959 period, those dividends, which ranged between 34 percent and 49 percent of net after-tax income, totalled $3,088,665. (E 2842).

point out is that every one of those machines infringed a Xerox-owned patent. (E 2677, 3339-40). As the district court noted, "[a]ll [new entrants] were sued by Xerox for patent infringement" (PA 58a) in an effort to remove each company from the market.

In short, the relevant facts are those found by the jury and set forth in the Petition. Xerox wilfully acquired and maintained a persistent monopoly in a multi-billion dollar nationwide industry. It restricted production, controlled prices and excluded competition. The court of appeals sanctioned Xerox's conduct, not by setting aside any of the jury's findings of fact, but by creating broad exemptions from the antitrust laws. Those exemptions should be reviewed by this Court.

Respectfully submitted,

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